

Statement of Dr. William E. Taylor
Before the Subcommittee on Communications
of the
Senate Committee on Commerce, Science and Transportation
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Good afternoon. My name is William Taylor. I am an economist. I am Senior Vice President of National Economic Research Associates, Inc., head of its Communications Practice and of its Cambridge Office. I have studied the growth of competition in the U.S. long distance market for nearly 10 years and have reported my findings in academic and industry publications and in filings advocating entry by the former Bell companies ("RBOCs") into interLATA services as necessary to promote the public interest.

In short, my conclusions are that RBOC entry into interLATA long distance markets is good and that such entry is not bad: i.e., (i) "good" in the sense that customers—particularly residential and small business customers—have not received the lower prices that we would expect from vigorous long distance competition, and RBOC entry would increase competition and lower prices substantially, and (ii) "not bad" in the sense that RBOC entry under current conditions would be unlikely to have anticompetitive consequences. In particular,

the economic benefits from RBOC entry into long distance markets are large, immediate and real, while

the economic costs—measured in terms of potential harm to long distance competition—are hypothetical, speculative and unlikely.

In weighing real benefits against hypothetical costs, Congress and the FCC have joined with most economists in favoring open, market-based competition as the organizing force in telecommunications markets. There is no more fundamentally anticompetitive regulatory action than preventing a firm from competing.

I. RBOC entry into interLATA markets is Good.

A. Consumers would benefit from additional interLATA competition.

That there is much room for improvement in the competitiveness of the U.S. interLATA toll market should not be surprising: the long distance marketplace has many characteristics that are associated with less-than-competitive performance. The market was previously regulated and is currently highly concentrated. It has been dominated for many years by a single firm and has a history of parallel pricing among three. Prices (net of access charges) remain far above marginal cost despite evidence of excess capacity in the market.

The long distance carriers' assertion that one more long distance competitor—initially a reseller—can't matter is wrong. The difference is the reputation and customer relationships that each RBOC already has with nearly every household in its territory. When any carrier offers a package to its current customers, it is much more successful than when an unknown entrant attempts to sell resold toll service. The effect of RBOC entry in its territory—initially at prices slightly below prevailing market prices—will be to drive the market price significantly below its current level.

B. Toll prices far exceed marginal cost by any definition.

Retail interstate toll prices run between 10 and 20 cents. Carrier access is 6 cents. Non-access marginal costs are about 1 cent. Margins thus run from 3 to 13 cents per minute, significantly larger—per minute—than the margin in switched access charges.

C. Toll prices have been rising in lock-step while costs have been falling.

While there is some technical debate regarding the proper measurement of long distance price changes, there is no question that long distance prices net of access charges have risen for residential customers:

- From 1991 through the end of 1996, AT&T increased basic residential interstate rates by a cumulative total of about 28 percent or about 4 cents per

minute. Yet during that period, access charges dropped by about 13 percent or \$0.009 per conversation minute. Net of access charges, AT&T raised basic interstate rates by about 62 percent or roughly 5 cents per minute. In 1997, basic residential rates net of access rose by another 0.1 cents per minute. While a minority of customers are eligible for discounts from these basic rates, (i) no increase in discounts could overcome this increase in basic rates, and (ii) since discounts are tied to the basic rate, prices for customers on discount plans rose by the same percentage as the increase in basic rates.

- Alternatively, according to AT&T, its average revenue per minute (“ARPM”) fell by 8 cents a minute from 1984-1994, while its access charges fell by 11 cents. Thus, a decade after divestiture, AT&T’s ARPM from residential customers increased 3 cents a minute net of access charges. Since 1994, AT&T has managed a 22 percent increase in basic residential rates during a period in which access charges fell by 9 percent.
- More recently—on January 1, 1998—per-minute carrier access charges fell by about \$3.49 billion annually, offset by an increase in the universal service fund of \$1.22 billion, a flat-rate charge on presubscribed lines amounting to \$1.85 billion, and an increase in special access trunking charges of \$0.08 billion. While long distance companies were quick to institute flat-rate charges and surcharges on their customers’ total bills to recover at least a portion of the increased access fees, they have to date done nothing to pass through the lower per-minute access charges. According to my calculations—using data supplied by AT&T, MCI to the FCC—AT&T and MCI are currently over-recovering the total January 1 access charge changes at a rate that exceeds \$1 billion per year.

Customers—particularly residential and small business customers—have yet to see the effect of the massive access charge reductions in their long distance bills. While the long distance carriers cite the introduction of lower ARPM services (e.g., 5 Cent Sundays) as the mechanism by which customers receive price reductions, a competitive market would do better for customers. In an effectively competitive market, a reduction in marginal and average cost would be passed through fully to customers in prices that are not simply lower, but are lower than they otherwise would have been. Thus, normal price reductions from productivity growth and reductions in ARPM from the introduction of new services and from customers’ shifting to lower-priced, lower-cost services do not count as a pass-through of an access charge reduction.

A. RBOC entry has reduced toll prices where it has occurred.

Because RBOCs are a large potential competitive force in long distance, prices have fallen by roughly 25 percent where RBOCs have entered the market. It is not the case that RBOCs enter at a price 25 percent below AT&T or MCI; rather RBOC entry at slightly lower prices ultimately pushes the market price down by about 25 percent.

- IV. The New York – New Jersey and Philadelphia – New Jersey corridors: Bell Atlantic prices about 20-30 percent below AT&T and competition has been sufficiently effective that AT&T petitioned to the FCC to deaverage its corridor rates to compete.
- V. SBC entry into cellular long distance lowered cellular long distance prices by about 40%.
- VI. SNET priced significantly below AT&T regular and discount services in Connecticut, driving AT&T prices down to temporary/restricted price of 5¢ per minute and causing AT&T and MCI to petition to the FCC to deaverage their interstate rates in Connecticut to compete.

The benefits to consumers of additional competition and greater price reductions are large: the increase in consumer surplus runs about \$10 per customer per month, depending on current rates and long distance usage. These gains are robust to changes in assumptions and are large relative to the likely gains from local competition because prices for long distance are much greater than cost, while regulated local prices are at or below cost.

VII. RBOC Entry is not Bad - i.e., not anticompetitive.

Against \$10 per line per month in direct benefits, what are the possible costs?

A. RBOC entry in long distance does not require effective competition in the local market to avoid anticompetitive outcomes.

Long distance carrier economists claim that effective local competition is necessary before BellSouth long distance entry is in the public interest. This assertion is bad economics and bad public policy, as recognized by the FCC [*Ameritech Order* at ¶388]. The presence of effective competition is the economic standard for deregulating local service, not for permitting long distance entry. The local market requirements in the Act, in economics and in the Section VIII-C requirement of the Modification of Final Judgement have nothing to do with effective

local competition or absence of local exchange market power, but rather parity of interconnection between RBOC long distance affiliates and their competitors, as specified in the checklist and Section 272 safeguards.

B. Competition has worked in other bottleneck access markets.

We've experienced successful competition between RBOCs and others in numerous bottleneck access markets for years. Competition has thrived for 10 years in intraLATA toll markets in most states, under circumstances comparable to those in interLATA toll markets. Similarly, competition with RBOCs has worked successfully in other markets having bottleneck characteristics, including (i) corridor toll services, (ii) cellular, paging, PCS and other wireless services and (iii) sales of consumer equipment. Finally, interLATA long distance competition already occurs in territories served by Sprint/United, GTE and SNET among others despite the absence of effective local competition, checklist compliance, fully automated and tested OSS and access parity. Yet no one would argue that long distance competition in these markets has not been in the public interest.

C. Delay is costly.

Microregulation of the details of local exchange interconnection cannot succeed. It will never be in the interest of RBOC customers to concede that their access to UNEs and resold services meets the checklist requirements. Thus, we cannot simply wait until the systems unambiguously supply access parity to every party's satisfaction. Delay directly costs long distance customers about \$10 per line per month and indirectly diminishes the incentives of long distance carriers to enter local exchange markets.